

# Priorities

on translating strengthening fundamentals into higher corporate value

**Ken Mizutani**  
President

Despite some external factors that impacted our bottom line, by concentrating on core competitive strengths, we have made our fundamentals and our prospects stronger than ever: Unit sales of our main product rose, especially in Japan, China and the U.S. We have successfully added production capacity to serve soaring demand. Our new product, “Gel-200,” is now moving through a PMA review in the U.S., and our other themes are to make steady progress in clinical trials.

We hope these trends in sales, production and R&D signal a significant rise in our long-term performance, for this is our goal.

Under the newly formulated 10-year vision and mid-term plan, we have clearly laid out the steps we intend to take to become a more competitive “global category pharma” in the glycoscience field, our specialty for going on 60 years.

In the year ended March 31, 2009, in spite of the global recession, we increased unit sales volumes across most of our product lines. Even so, consolidated net sales declined by 1.5% to ¥27,207 million as a result of the yen appreciation and backwash from the shipment carryover that artificially raised export sales in the previous year. Operating income fell by

## 5-year Financial Summary

	Millions of Yen					Thousands of U.S. Dollars (Note 1)
	'05/3	'06/3	'07/3	'08/3	'09/3	'09/3
Net Sales	¥ 22,565	¥ 23,144	¥ 24,353	¥ 27,630	¥ 27,207	\$ 277,623
Overseas Sales	6,004	6,095	6,400	7,770	7,463	76,153
Overseas Sales Ratio (to Net Sales)	26.6%	26.3%	26.3%	28.1%	27.4%	27.4%
Gross Profit	15,723	15,976	16,554	18,682	17,223	175,745
R&D Expenses	3,655	3,489	4,537	5,654	5,965	60,867
Operating Income	6,785	6,901	5,572	6,677	4,730	48,265
Operating Income Ratio (to Net Sales)	30.1%	29.8%	22.9%	24.2%	17.4%	17.4%
Net Income	3,625	4,678	3,535	4,244	3,175	32,398
Net Income Ratio (to Net Sales)	16.1%	20.2%	14.5%	15.4%	11.7%	11.7%
Total Equity	46,426	50,693	52,833	53,646	52,309	533,766
Return on Shareholders' Equity (ROE)	8.1%	9.6%	6.8%	8.0%	6.0%	6.0%
Total Assets	51,544	57,332	59,244	60,620	58,215	594,031
Return on Total Assets (ROA)	7.3%	8.6%	6.1%	7.1%	5.3%	5.3%
Consolidated Dividend Payout Ratio	32.8%	31.5%	41.0%	40.7%	44.9%	44.9%
			(Yen)			(Dollars)
Net Income per Share of Common Stock (Note 2)	60.93	79.24	60.93	73.67	55.68	0.57
Cash Dividends per Share of Common Stock (Note 3)	20.00	25.00	25.00	30.00	25.00	0.26
Number of Employees	535	544	557	594	609	

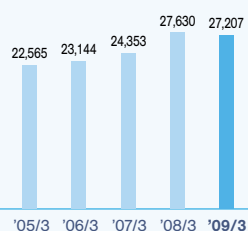
Notes: 1. U.S. dollar amounts are converted, for convenience only, at the rate of ¥98=US\$1, the approximate rate at March 31, 2009.

2. Per-share figures have been retroactively adjusted for stock split at May 20, 2005.

3. Cash dividends per share are dividends applicable to the respective years including dividends to be paid after the end of the year, retroactively adjusted for stock split at May 20, 2005. (See Notes 9 and 14.)

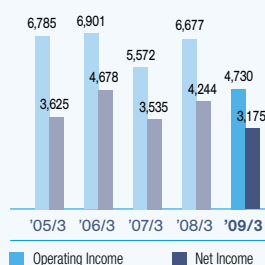
### Net Sales

(Millions of Yen)

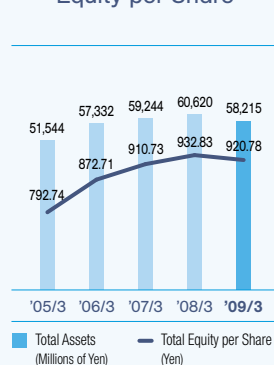


### Operating Income and Net Income

(Millions of Yen)



### Total Assets and Total Equity per Share



### R&D Expenses and Ratio to Net Sales



## Message from the President

29.2% to ¥4,730 million. The decline was due to cost increases related to investment in future growth, including a rise in R&D expenses and the start of depreciation on the No.4 Production Building at Takahagi Plant. Net income was down by 25.2% to ¥3,175 million.

### ARTZ® sales expand in Japan

The Japanese pharmaceutical industry operates under medical-cost containment pressures by the government. Nevertheless, sales of our main product, ARTZ®, continued to expand. In the year under review, propelled by overall market growth, unit deliveries of ARTZ® to medical institutions in Japan increased by 11.4%. The rising deliveries offset a 5.8% reduction in the NHI reimbursement price, resulting, as well, in growth in sales for ARTZ®. While the elderly population continues to grow, a large portion of the market expansion is due to our stepped-up sales promotion activities with our sales partner, Kaken Pharmaceutical Co., Ltd., which are aimed at raising public awareness of knee osteoarthritis and the importance of early treatment. The campaign began in FY2006, and we continue to see a steady increase in the number of hospital visits by patients with knee osteoarthritis and

the number of hospitals that offer hyaluronic acid treatment.

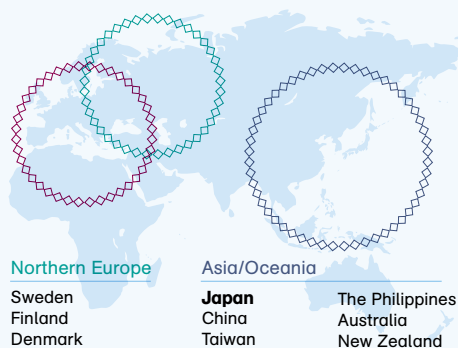
The campaign, which is conducted in compliance with strict advertising regulations of the Pharmaceutical Affairs Law, has to this point included such activities as newspaper and magazine advertisements and participation in a public-television sponsored symposium on knee osteoarthritis. We also continue to promote it among not only orthopaedists, but also internists, surgeons and anesthetists. Furthermore, to meet the still-growing demand for ARTZ®, we reinforced the production infrastructure to ensure that supplies remain adequate.

### Unit sales of ARTZ® rising overseas

ARTZ® sales overseas are seen as a strategic driver of overall sales growth. While the Japanese market continues to grow steadily, the U.S. and China, our two most-promising overseas markets, hold the keys to significant additional growth into the future.

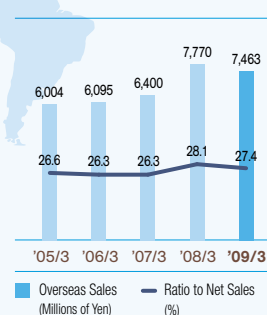
SUPARTZ® is the brand name for ARTZ® in the United States, sold through our sales partner, Smith & Nephew, Inc. (S&N). Under pressure from rising competition, the sales growth rate on a U.S.-dollar basis has been easing since FY2007. Sales prices have also fallen. However, a strong campaign by S&N

### ARTZ® series approved in 21 countries

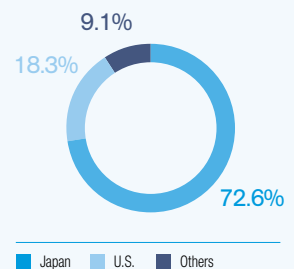


- Western Europe**
- Italy
  - Austria
  - Portugal
  - Netherlands
  - Belgium
  - U.K.
  - Germany
  - France
  - Spain

Overseas Sales and Ratio to Net Sales



Sales by Region



## With Zimmer as a sales partner for Gel-200 in the U.S., we aim to reach different customers, tapping into what amounts to a new category within the market.

pointing out that SUPARTZ® is the most-widely used injectable hyaluronic acid product in the world helped to increase unit sales volume in the U.S. by around 6%. As a result, SUPARTZ® retained its No.2 position in the market. Our export sales to the U.S. fell by 20.8% compared to the prior year, largely because of the yen appreciation, and in part because shipments to S&N last fiscal year were inflated when fulfillment of some orders from two fiscal years previous was postponed into the year ended March 2008.

In other export markets, ARTZ® sales rose 26% in total. Sales in the growing Chinese market are expanding well, based on the reputation of ARTZ® for high quality and safety stemming from its Japanese manufacture and FDA approval.

### ARTZ® shows long-term potential for growth

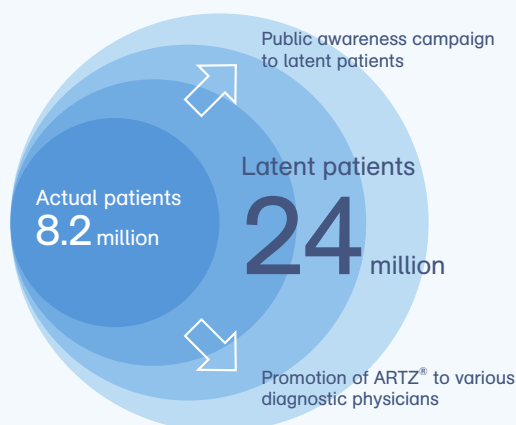
The top share of the joint-function improving agent market in Japan is held by ARTZ®. There are about 8.2 million patients with knee osteoarthritis in Japan and an estimated additional 24 million latent sufferers who are currently untreated. This three-to-one, untreated to treated, ratio helps to explain why our public awareness campaign has been so effective. On top of that, the

elderly population in Japan is estimated to be growing by 2–3% per year through 2020.

The situation is very similar in the U.S., which is also a growing market with high potential that we aim to leverage further by introducing Gel-200. While SUPARTZ® is administered with multiple injections for one treatment, Gel-200 is a single-injection formulation. We have developed this as a new therapeutic approach for the U.S. market. The new formulation, with higher molecular weight hyaluronic acid, is designed to remain in the joint cavity longer and reduce the frequency of injections. Some insurance providers tend to limit the total number of injections in a patient's lifetime, and this product is tailored for that situation. As our sales partner for Gel-200 in the U.S. we chose Zimmer, Inc., one of the global leaders in the field of orthopedic surgical products. Because Zimmer is the U.S. market leader in replacement knee joints, which are used in the same therapy field as hyaluronic acid injection formulations, we anticipate that Gel-200 sales will grow to a prominent position in the single injection market. Having both multiple and single injection products sold by two respective partners will give doctors and patients greater choice and, we think, promote the development of two distinct markets.

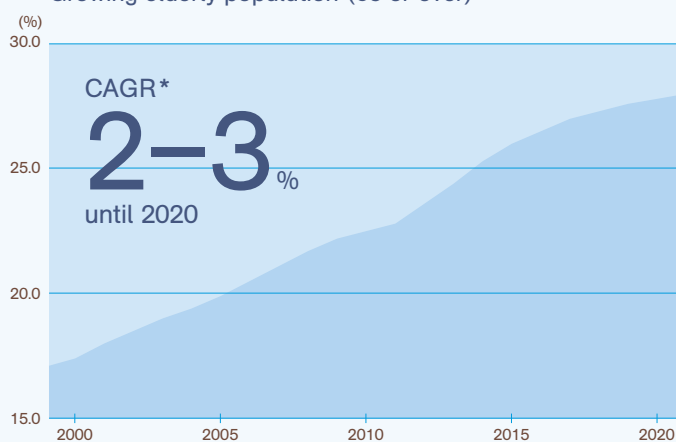
### Potential for market growth in Japan

#### Large number of patients remain unreachable



Source: Tokyo University

#### Growing elderly population (65 or over)



Source: Ministry of Internal Affairs and Communications

\* CAGR: Compound average growth rate

## Message from the President



### Realizing higher value from R&D

I would like our shareholders to take note of the progress we have made in the development of new products. Gel-200 is waiting for FDA approval, and we submitted an application with the FDA for SI-602, an additional indication of SUPARTZ<sup>®</sup>, for shoulder osteoarthritis in September 2009. We recently completed target enrollment for a Phase II/III clinical trial for SI-6603 in Japan and are conducting a Phase II trial in the U.S. This is a non-surgical treatment of herniated lumbar discs that we think has big growth potential.

Furthermore, to raise efficiency, we are reorganizing into cross-divisional teams on a theme basis, in which members from different parts of the Company work cooperatively to move po-

tential products through the research, development, production and marketing stages.

### Becoming a more competitive “global category pharma”

Our newly formulated 10-year vision defines a roadmap for long-term growth and success. In it, we clarified our definition of a “global category pharma” and identified the essential elements for our survival. We envision becoming more competitive on a global basis with a strategically narrowed focus.

Our business areas are all related to a field in which we excel, glycoscience—and specifically GAGs—because, such areas are rather difficult for mega pharmaceutical companies to enter, but large enough to reward us for the cost of research

## Our goal is to develop the capability to add a new profit-generating business every three years by either introducing a new product or by entering a new market.

and development and support the cash flow to develop a steady stream of new drugs that can compete worldwide. Our 10-year vision will guide us to develop the capability to introduce a new product or enter a new market every three years—in other words to continually create new profit-generating business.

As we have no in-house sales force, the drivers of this vision are our production and R&D. We are continually upgrading our production—in terms of capacity to meet demand, safety and purity. R&D, of course, must provide a steady stream of new products with which we can grow.

### GPS (Global, Powerful, Sustainable) Mid-term Plan FY2009–2011

To launch us firmly toward fulfilling our 10-year vision, we have set out targets for the first three years. This new mid-term plan lays the important foundation for achieving the 10-year vision. We've named it "GPS," for Global, Powerful and Sustainable. Under "Global," we seek to maximize business opportunities by expanding cross-border activities in sales and network development. Under "Powerful," we seek to strengthen the corporate organization to best achieve our 10-year vision. And, under "Sustainable," we will seek to be a good corporate citizen in a highly regulated industry.

The plan calls for raising of net sales from ¥27.2 billion in FY2008 to ¥30.5 billion in FY2011, and operating income from ¥4.7 billion to ¥6.0 billion, respectively, and we intend to reach

higher. Achieving these goals depends on successfully expanding sales of our existing products, ARTZ<sup>®</sup> and OPEGAN<sup>®</sup>. We also expect early sales of Gel-200 to make a contribution. Our assumptions also take into account the ongoing depreciation of new manufacturing facilities, R&D expenses targeted at 20% of sales and the 2010 NHI price revisions.

### Forecast for the year ending March 2010

For the year ending March 2010, overseas unit sales volumes will climb modestly, but steadily, although continuing pressure from yen appreciation will depress export sales values slightly. Additionally, depreciation of the No.4 Production Building will peak. Nevertheless, we expect to record higher sales and profits, through domestic sales volume growth and royalty payments. In Japan, we forecast a 10% rise in unit deliveries to medical institutions for ARTZ<sup>®</sup> and 6.9% for OPEGAN<sup>®</sup>, and, with no NHI price reduction scheduled, the rising sales volume for these major products will lift total net sales by about 7.3%. Total net income is expected to climb by around 16.5% in the year.

### Moving forward together with long-term focus

Our policy of a performance-oriented dividend is also based on the long-term vision: a yearly dividend payout ratio exceeding 30% on a consolidated basis, with ¥20 per share as the base amount. In the year ended March 31, 2009, we exceeded these levels with an annual dividend of ¥25, for a payout ratio of 44.9%. Furthermore, following authorization by the Board of Directors, the Company bought back 700,000 common shares (spending ¥748 million in total).

We have set a long-term horizon for your expectations, and I believe we will become a more highly competitive global category pharma as our fast-strengthening fundamentals translate into higher corporate value. We will work continuously to build stronger relationships of trust with shareholders and other stakeholders.

Ken Mizutani  
President



### Dividend Payout/ Payout Ratio

